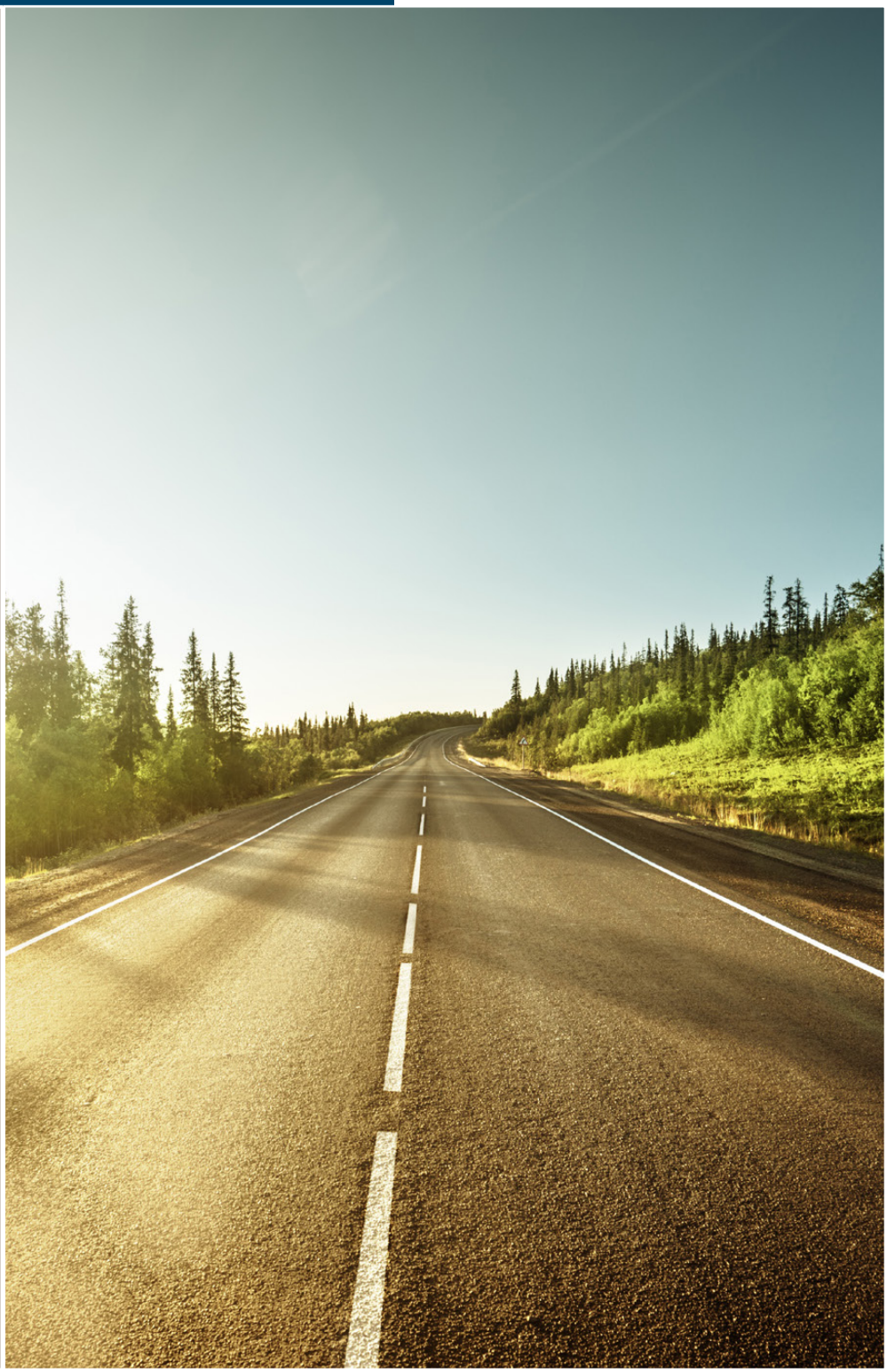
The Evolving Dealership – 2030 and Beyond

AutoTeamAmerica



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Introduction

Dealership operators are often laser-focused, rightly so, on month-to-month trends impacting sales, service and ultimately, bottom-line profitability. However, this dedication to details often clouds dealers' ability to see longer-term trends forming across the sector. Auto Team America (ATA), formed in 1993, is an amalgam of CPA firms and auto industry solution providers that serve thousands of auto retailers nationwide. It is ATA's goal to provide data-driven, in-depth analysis and perspectives on key themes and trends likely to impact auto dealers in the decades ahead, rather than months.

As an update to ATA's prior white papers "A Strategic Vision of Dealerships in 2025" published in 2012, "2025 Dealership Vision: What Lies Ahead!" published in 2014 and "2030 Dealership Vision: The Road Forward!" published in 2017, ATA has collected data among auto retail leaders to (1) take stock of performance trends to date in order to validate and/or invalidate original predictions posited in prior papers while (2) formulating new perspectives on the evolving auto dealership model for your consideration and future planning in the period 2030 and beyond.

Key themes from our prior reports that continue to ring true in 2020 include (1) sector consolidation, (2) OEM-required facility upgrades, (3) the digitization of customer communications in sales and fixed operations, (4) offsetting new vehicle gross margin pressures with greater focus on "other income", and (5) managing to a lower, leaner cost structure while also remaining focused on limiting employee turnover.

Certain discussion points from our prior reports will likely take longer to play out than originally anticipated, including electrified vehicles (EV), autonomous vehicles (AV), and changes to state franchise laws. Many experts had the view that greater regulation could force virtually all vehicles to be fully electrified and/or hybridized by 2025, or that ride-sharing would quickly emerge as a practical replacement for vehicle ownership. Still others believed autonomous vehicle technology would develop so rapidly that computer-driven vehicles would "rule the roads by 2030." More directly related to retail automotive, there had been a period when many believed the repealing of dealer franchise laws was a distinct possibility in the near to medium term. While we continue to see substantial public and private study and investment in ride-sharing, electrification and autonomy, it appears far less likely today that either EVs or AVs will result in material disruption to retail automotive in the reasonably near (10-15 year) term. It is also true that the discussion related to modification of franchise laws has subsided considerably.

Looking ahead to "2030 and Beyond", this paper targets three special focus topics, referred to herein as "The Big 3." These topics include (1) People and Personnel, (2) Electrification and Autonomous, and (3) The Evolving Dealership.

Today, there is increasing uncertainty surrounding the retail dealership environment, not the least of which includes ramifications from possible trade wars, an economic recession, a broader push for electrification, and technology influences from investments in autonomous vehicles. There is also significant uncertainly regarding trends more directly impacting dealer operators such as customer subscriptions, sector consolidation, generational shifts, facility needs and the seeming plateau of new vehicle industry sales putting more pressure on dealers to offset with increased used, F&I and fixed operations gross profits all while maintaining an efficient, and still evolving, cost structure.

As highlighted in our Executive Summary herein, Auto Team America believes that while the big disruptors to auto retail may not have occurred by 2030, they will likely be well on the horizon. Dealerships will likely have to evolve to diversify and have solutions in place to respond to the effects of electrification, autonomy, digital sales, and changing personnel expectations by that point in order to thrive in the coming decade. ATA sees smaller staffing requirements as the use of technology rises and more customers opt to communicate digitally rather than face-to-face. The pace at which consumers adopt electrification remains in question, though dealers will have little choice but to make calculated guesses regarding fixed operation investments as virtually all OEMs' have stated clear goals of increasing EV production in the next 10 years. Dealers will also need to consider consumers' potential appetite for shared ownership and may need to consider owning and managing a fleet of rental vehicles for such demand. Lastly, we anticipate as generational issues persist among dealership operators, and in light of potential looming economic, operational, product and consumer driven headwinds, private equity and family office ownership will likely grow in the coming decades in spite of ongoing manufacturer apprehensions.

A brief note before we begin about the limitations of this paper. While outside influences of the general economy, interest rates, unemployment and related macroeconomic issues will certainly impact dealership operations, those items are beyond the scope of this paper. Instead, we will concentrate on retail dealership operations as they continue to evolve and address the opportunities and challenges that lie ahead.

SPECIAL FOCUS TOPICS ("THE BIG 3")

PEOPLE AND PERSONNEL

According to a 2019 Urban Science webinar presented by Automotive News Power Training, 72% of consumers believe salespeople have an expertise that is necessary to help navigate the complex vehicle buying process.[1]

Hiring and retaining quality sales and fixed operations personnel remains without question one of the most important and challenging goals for auto retailers looking ahead into the next decade and beyond. Auto retailers will have to work harder to attract and retain top-quality personnel that can be multi-dimensional, are trained to utilize newer customer-engagement technologies and are capable of performing key functions throughout the dealership.

While automation may reduce overall headcount, dealers will also have to attract higher skilled and presumably higher cost talent. Dealers will need to compete on the merits of work-life balance, job security and opportunities for advancement in order to attract top talent. Dealers will need to invest in technologies that help to blend increased automation with evolving labor demand, or said another way, dealers will need to become experts in developing an "omni-channel" (online blended with brick and mortar) approach to automotive retailing. The goal in blending e-commerce and traditional retail strategies is to strike a balance that (1) delivers the experience consumers want, and (2) rewards and invigorates talented employees while (3) investing in a cost structure that incentivizes productivity, scalability, and reduced down time. Dealers will need to consider updating their training processes as traditional promotion tracks (e.g. hiring entry-level, lesser skilled labor and training/promoting from within) become less effective. In order to remain competitive with other industries, dealerships will have to offer more personal time away from work and increased job security in the form of higher base salaries and less reliance on commissions and incentive-based compensation. Fixed cost positions, such as cyber security oversight and IT systems maintenance, will expand throughout the industry. The next generation "entry-level" employee will likely have some college education, while management employees will likely require college degrees with service technicians necessitating two-year training certificates.

Technology is also impacting the roles of sales personnel within auto dealerships. Dealers are doing a better job of engaging with consumers online or remotely through some form of a digital intermediary (e.g. third-party OEM site, lead generator, mobile application). The increasing ability to research vehicles online means customers are entering dealerships more informed about vehicle features and pricing, which requires showroom employees that more closely resemble consultants or product specialists rather than what dealers may consider a "traditional" sales person. The opportunity for dealers is to use technology to streamline the purchase and delivery process, which can also result in greater customer loyalty to sales and service lanes over time and act as a key differentiator among dealership peers. Auto retailers must consider their retail competition to no longer be the closest similarly franchised dealership, but rather the customers' most recent retail experience, which may include experiences with Amazon and/or Apple.

Vehicle technology is also changing at an accelerated rate, as manufacturers work to attain stringent global emissions requirements vis-à-vis the introduction of hybrid and fully-electrified vehicles. The shift to hybrid and electrified vehicles is also resulting in a quickly evolving service and parts personnel landscape. In the short to medium term, it is likely more complex hybrid vehicles will generate more complicated, bigger ticket repair orders for service lanes, which may also require higher skilled and therefore higher-paid technicians. Longer-term, many believe simpler, fully electrified vehicles may lower parts and repair counts and also reduce the need for skilled labor. Concurrent with the growth in EVs is the growing view that flat rates may disappear from a combination of restrictive employment laws and increased job competition for technicians. Some even believe technicians might become similar to "Apple Geniuses" in diagnosing technology requiring different skill sets. More dealers are also assessing the viability of mobile repair services and whether such services will require hiring yet another group of technicians with varying skill sets and service experiences. Extending this logic to the parts department, there is a growing view that dealerships may be able to reduce headcount as more parts activities become automated.

[1] "What science reveals about today's automotive customer journey" – webinar © 2019.

ELECTRIFICATION AND AUTONOMOUS

Perhaps one of the most contentious debates in the auto industry at the beginning of the last decade concerned vehicle electrification. Will manufacturers build it? And if so, will consumers want it? Fast forward to 2020 and while the debate rages on, there is little question as to whether manufacturers are investing in electrification, but still doubt as to whether there is sufficient demand to support such investments. Needless to say, as virtually all OEMs are planning to produce more hybrid and fully-electrified vehicles, dealers will need to keep pace with the level of investment required to educate consumers, offset potential internal combustion engine (ICE) vehicle devaluation and partner with public and private agents to build the charging infrastructure that will help power the transportation of tomorrow.

A more provocative, though still widely debated, argument revolves around the concept of autonomous vehicles. Manufacturers have been studying autonomous technologies for decades, though it seems roughly mid-way through the last decade investment managers, the media and now consumers have all started to pay closer attention to the idea of self-driving. Fueled by lofty manufacturer projections, expectations for fully-autonomous fleets roaming the streets in the early 2020s are saturating the market. However, there is little evidence vehicles are ready for "prime-time", so to speak, and still significant testing demanded by regulatory bodies will likely push this timeline well out – meaning decades - into the future.

The insurance market is also likely to experience dramatic changes in the next decade given revolutionary vehicle technologies and shifts in vehicle ownership trends. The proliferation of advanced onboard technology is already resulting in significant impacts to auto insurance companies as (1) advanced safety systems are driving lower collision frequency offset by (2) higher repair costs per part given more complex onboard hardware and software suites. According to the 2019 Crash Course report published by CCC Information Services, rolling 4-quarter private passenger auto collision frequency fell by a rate of roughly 1-2% year-over-year through 3Q18, a significant reversal from the up +1-5% year-over-year trends from 2014-2017. However, the same report also shows auto collision severity (cost) rebounding higher to more than +4% year-over-year growth through 3Q18 from flat to slightly negative year-over-year through late 2017. CCC Information Services found that the percentage of all collision appraisals of vehicles with sensors, cameras, radar, lidar and other advanced vehicle technologies jumped from just over 4% in 2014 to roughly 6% in 2018 while the average cost per component replaced grew from $153 to $195 (+27.5%) over the same period. CCC also noted while advanced driver assistance systems (ADAS) help drivers avoid collisions, they are powerless in helping avoid significant weather events. CCC highlighted the likelihood that more frequent and severe catastrophic events resulting from global climate change could also contribute to higher repair costs over time.

Licensed Drivers Discussion

Given increased vehicle complexity driving higher overall insurance costs, it is no surprise the average expenditures for auto insurance have risen from $812.40 in 2012 to $935.80 in 2016, according to the Insurance Information Institute. However, what has been debated more broadly is the effect that rising vehicle insurance costs may have on demand for vehicle ownerships. Given the exponential growth in ride-sharing and ride-hailing services in the past decade, some are quick to draw conclusions that any decline in licensed driver registrations is indicative of a structural shift away from vehicle ownership.

Average Expenditures* For Auto Insurance, 2007-2016

Year	Average Expenditures*	% Change (Y/Y)
2007	$798.54	(2.4%)
2008	$790.66	(1.0%)
2009	$786.65	(0.5%)
2010	$789.29	0.3%
2011	$795.01	0.7%
2012	$812.40	2.2%
2013	$838.61	3.2%
2014	$865.46	3.2%
2015	$889.09	2.7%
2016	$935.80	5.3%

Source: National Association of Insurance Commissioners (NAIC), 2018.

* We note that "Average Expenditures" in the chart above as measured by the NAIC assumes all insured vehicles carry liability coverage but not necessarily collision or comprehensive coverage. According to Insurance Information Institute, "average expenditures measure what consumers actually spend for insurance".

According to the U.S. Department of Transportation, relative to 1983 the percentage of licensed drivers has fallen in all age groups 40 and below, in some cases by more than 20% over that period. On the surface this appears to confirm the argument that yes, a major structural change across generations has occurred and yes, that means consumers are simply less interested in driving and therefore vehicle ownership.

However, it is also true in the most recent data (2014-2016) that the percentage of licensed drivers actually began to increase across all age groups. Why is this meaningful? Because it happens to coincide with a significant rise in ride-sharing/hailing services over the past decade. Digging deeper we learn that according to the U.S. Census Bureau the percentage of consumers commuting alone by car, truck or van has remained remarkably steady at roughly 77% over

the past several decades. Over a similar period we note carpooling has fallen from 11% to 9% of the commuting population and shifts in public transportation, walkers, taxi and bicycle users have remained steady, generally appearing to offset one another.

Taken together, it appears data is still inconclusive as it relates to licensed driver and vehicle ownership trends. It may simply be that fears surrounding younger generations' lack of interest in driving are overblown. It may also be that urbanization and tele-commuting are on the rise. According to the U.S. Census Bureau tele-commuters have risen from 3.6% to 5.1% of the population from 2005 to 2017. While we agree more urbanization and tele-commuting are not great signs for vehicle ownership long-term, neither present the immediate, existential crisis some have drawn between increased ride-sharing/hailing and decreased vehicle ownership.

It seems younger generations, for some time, have postponed obtaining drivers licenses. Recent data indicates this trend is changing as a growing number are now getting licenses. It may be that with age comes responsibility and family formation. As this happens, as it has for generations, taxis, carpooling and public transportation are simply less attractive and less practical for many individuals relative to private vehicle ownership. Assuming younger professionals can afford to privately own vehicles, we would expect the next decade to reveal that fears surrounding ride-sharing's "war on vehicle ownership" may be premature.

Impact of EVs and AVs on Vehicle Ownership

Looking more closely at the concepts of electrification and autonomous driving, what, if anything, should dealers be doing today to plan for the future? To put these questions into better context we consider pricing, availability, competitiveness vs. ICE powertrains, and charging infrastructure that together, will likely underpin electric vehicle demand (or lack thereof). Separately, we consider consumers' appetite for vehicle ownership as being the single greatest factor driving demand for growth in ride-sharing fleets. By extension, we believe growth in ride-sharing usage is highly dependent on increased penetration of Autonomous Vehicles as the cost of human drivers is the single greatest hurdle to achieving sustainable profitability long-term for ride-hailing companies. Lastly, having provided some context for the EV/AV debate, we will highlight key investments dealers should consider over the long-term to remain competitive as the vehicle landscape shifts over time.

Pricing

According to Kelley Blue Book, the average price for a fully electric vehicle averaged $55,994 in 2019 through October,

which is down roughly -11% year-over-year relative to the $62,649 average in 2018. While top selling lower-priced EVs like the Model 3 seem to be driving overall EV prices down, EVs are still roughly +50% more expensive than the average new vehicle sold in the U.S. during 2019. The significant price premium of EVs versus average new ICE vehicles casts doubt as to the true underlying demand, and therefore mass-market potential for electric vehicles to this point.

Availability and Competitive Pricing of EV vs. ICE Vehicles

Back in 2017, several of the largest global OEMs had publicly articulated plans for dozens of new electric and/or electrified vehicles by the early-2020s. Among those manufacturers were luxury brands such as Audi, Jaguar, Porsche, BMW and Mercedes-Benz, all of whom have had significant production and dealer delivery delays since announcing their next generation electrified fleets. Perhaps most surprising, even the newest EVs have found it difficult to compete with the now dominant EV manufacturer Tesla in terms of vehicle range and price. Luxury EVs have become substantially more expensive than anticipated and lack the practicality to convince the vast majority of consumers to trade-in or opt-out of internal combustion powertrains. Moreover, many OEMs, particularly among luxury brands that are highly dependent on leasing, lack the data to appropriately set residual pricing on their newest EV models, which makes it more difficult to compete against vehicles even within their own portfolios.

EV Infrastructure

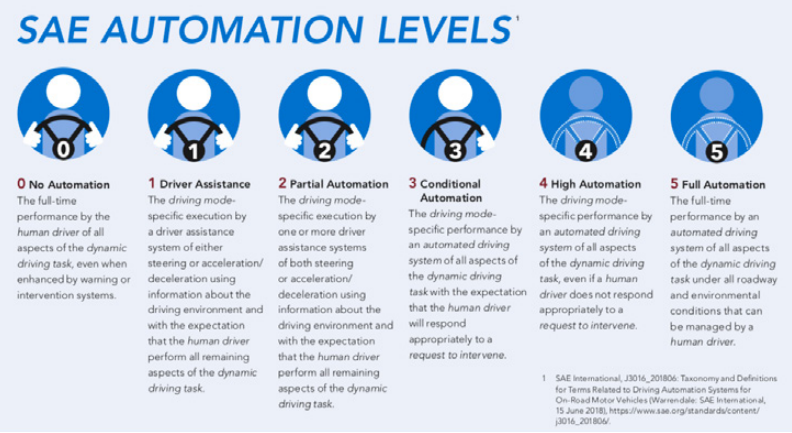
Another significant limitation of EV technologies is charging infrastructure. Although there have been substantial investments among manufacturers, consumers, public and private companies alike into vehicle charging stations across the country, charging ports are still few and far between. And while charging technology is improving, it remains significantly more time consuming to re-charge an EV versus filling a tank with gasoline. There is also an issue of consumers' ability and/or willingness to invest in home charging units, which are arguably still reasonably expensive for the average home owner. Beyond that, there are yet vast numbers of consumers that cannot practically invest in home charging due to living circumstances. Despite limitations of EV demand, charger availability and charging technology, manufacturers continue to pass on significant investment demands down onto dealers, requiring franchise owners to make several hundred thousand dollar investments (well into the millions for larger groups) into on-site charging facilities, which considering delayed production and stagnant EV adoption, are unlikely to achieve suitable returns on investment for dealer operators for a significant period of time.

Resale and Service Considerations

In addition to pricing, availability, range and charging there are also questions related to resale value, repair costs and parts availability that continue to stymie EV demand. Manufacturers, dealers and consumers alike have little data to understand resale value of used electric vehicles and some are even encountering lengthy service shop delays due to the lack of replacement parts availability for the newest EV models. The good news for dealer service profits is that an influx of hybrid vehicles is likely to precede a (much) longer tailed adoption of fully-electric powered units. While EVs are considered less complex relative to internal combustion engines, hybrids are perhaps the most technically complicated vehicles on the market as they carry two powertrains in addition to myriad safety sensing, and electronically based features all new to the industry. As complexity rises so do repair costs, which will inevitably raise questions of non-discretionary (essential items) vs. discretionary (is adaptive cruise control essential?) service spending among consumers. How will consumers adapt to rising insurance costs given increased vehicle complexity? How will dealers choose to staff lanes and body shops as vehicle service protocols move to computer-driven diagnosis and complex sensor recalibration, which ultimately reduce demand for traditional labor skill sets and techniques? It may be good news for dealers that as OEMs lead the vehicle technology revolution these changes are likely to favor new and CPO vehicles relative to the aftermarket. That said, the question remains pertinent to what upfront fixed cost investments OEMs and new technologies will require.

Considering Autonomy

In October 2015, Apple co-founder Steve Wozniak stated "Self-driving cars is the biggest technology for the future… In 20 years, no human drivers will be allowed except for the young kids at Disneyland." In October 2019, Wozniak revised his views on AVs, stating "I stepped way back [on] this idea of Level 5. I've really given up. I don't even know if that will happen in my lifetime." Wozniak explained his reversal, stating "What we've done is misled the public into thinking this car is going to be like a human brain, to be able to really figure out new things and say, 'Here's something I hadn't seen before, but I know what's going on here, and here's how I should handle it. A human can do that."



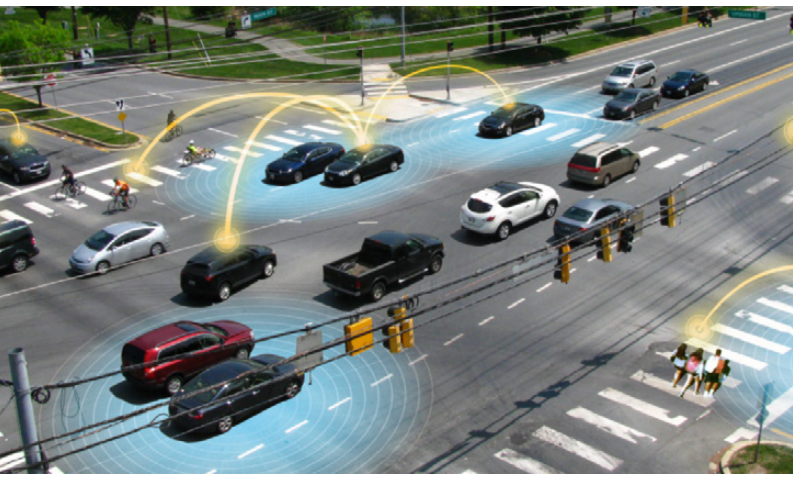
Sources: U.S. Department of Transportation, Society of Automotive Engineers International (SAE).

While it is clear the media hysteria has cooled and expectations for AV technology to reach the masses has pushed much further down the road since our last white paper, it does seem the public's underlying tone on EVs and AVs remains largely the same – the public really wants the technology, they want to move in that direction, but they are ambivalent as to whether they are willing to pay extra for it.

The discussion related to autonomy is synonymous with the discussions related to ride-sharing; will the public ultimately just view ride-hailing as another form of vehicle autonomy and thereby reconsider personal ownership? While the cost of vehicle ownership remains substantially higher than say, public transportation, the gap to private or even shared ride hailing/taxi services is quite narrow. Some say by eliminating the cost of a human driver, ride-sharing expense will plummet, and consumers will rush to unburden themselves from vehicle ownership, opting instead to travel by Uber or Lyft. And yet others view ride-hailing as a newer, more efficient taxi service, ideal for situations where driving

would have been burdensome (e.g. difficulty or high cost of parking and/or drinking alcohol at dinner) but falling short of a fully comprehensive transportation solution that can effectively replace vehicle ownership. Though provocative, it is clear AV regulation, much less AV technology, is in its nascent stages. It seems unlikely that the roll-out of an AV service, or at least one allowed to operate without a competent driver behind the wheel, will occur at significant scale in the foreseeable future.

It is believed that investments in smart infrastructure and vehicle to everything (V2X) technologies will ultimately pave the way for the proliferation of autonomous fleets. In 1999, the Federal Communications Commission (FCC) allocated 75 megahertz (MHz) in the 5.9 gigahertz (GHz) band to be used by intelligent transportation systems. This band is designed to be the primary channel for which dedicated short-range communication (DSRC) systems communicate information between vehicles and transportation infrastructure. Numerous industry associations and research institutes have worked for decades to study the potential use cases for DSRC (utilizing the 5.9 GHz band) as well as advanced cellular technologies predicated on the 5th Generation (5G) mobile network to enable seamless communication between vehicles and other vehicles (V2V), vehicles and pedestrians (V2P), vehicles and infrastructure (V2I), and vehicles with the cloud (V2C). It is believed the 5G network, in combination with DSRC technologies, will serve as the ground-breaking platform upon which new V2X technologies will operate and ultimately pave the way for autonomous vehicle deployment more broadly.



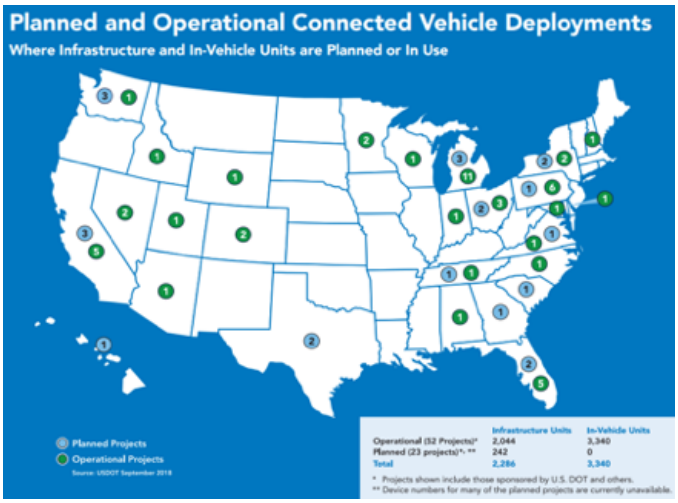
Sources: U.S. Department of Transportation.

In Ann Arbor, MI, the University of Michigan's Transportation Research Institute (UMTRI) is testing the deployment of such technologies in its Ann Arbor Connected Environment (AACE), which is self-described as the most advanced connected environment in the U.S. covering 27 square miles with 75 active Road Side Unit (RSU) installations and 2,500 Dedicated Short-Range Communication (DSRC) equipped vehicles. UMTRI utilizes AACE to study challenges related to connected and automated vehicle deployment by analyzing crash data, driver behavior, interactions between vehicles and pedestrians/cyclists. UMTRI partners with industry trade associations like the Intelligent Transportation Society of America (ITSA) and the 5G Automotive Association (5GAA) to run case studies and analyze use data related to V2X technologies. Organizations like UMTRI hope to provide the foundation upon which legislative bodies might craft regulations paving the way for broader V2X deployment, ensuring appropriate levels of cyber-security protections and by establishing design and implementation standards necessary for cross-industry investment and collaboration across the country.

As it relates to automated vehicle study and deployment, the U.S. Department of Transportation (DOT) launched DAVI, or Data for Automated Vehicle Integration, framework. The four guiding principles are to identify, prioritize, monitor and address data exchanges needed for automated vehicle integration, as highlighted in the chart below.

Sources: U.S. Department of Transportation.

As of September 2018, the U.S. DOT identified 52 sponsored operational connected vehicle deployment projects across the country with another 23 planned projects for the near future. There are also states combining Federal-aid Highway Program funding with state funding for such programs designed to study connected vehicle environments, advanced transportation and congestion management programs.



Sources: U.S. Department of Transportation.

That said, regardless of whether fleets will be fully-autonomous or human-piloted, what seems clear for dealers or would-be fleet managers is that AVs are almost certain to be EVs and ride-hailing vehicles which are likely to migrate to hybrid/electric powertrains in time.

DEALERSHIP EVOLUTION

According to a 2019 Urban Science webinar presented by Automotive News Power Training, significantly more dealers relative to consumers (79% of dealers vs. 52% of consumers) believe that apart from picking up the actual vehicle, 5 years from now every aspect of buying a new vehicle will be done online.

It seems, separate from the great powertrain debate, there is little question the auto retail model is evolving, and evolving quickly. Like other areas of specialty consumer retail, which have dealt with pressures first from big-box, discount retailers only to be followed by now behemoth online-only competition, auto retailers are facing mounting challenges, generally rooted in their customers desire to interact and consume more online rather than in-store.

There is little debate among dealers calling for the need to improve digital interfaces, both in store and online. Dealers across the country are investing in digital kiosks to streamline sales processes. Even more are investing fully in online service scheduling, enabling consumers to take greater ownership over the service process. There are yet other dealers experimenting with online financing

approvals, online vehicle appraisals and purchase offers, and still more piloting online purchase and home delivery models in select markets.

It is imperative dealers consider their online strategy, even if only to improve advertising and to provide means for positive customer feedback (now measured closely by manufacturers in assessing dealer efficiency). Dealers will need to invest in technology and personnel to address the increasing velocity of transactions occurring online and consumers' increasing demands for home delivery and off-site service. The good news for brick-and-mortar dealers is that, for the moment, states are not likely to abandon licensing protections, which helps to insulate the impact from growing online-only competition. Moreover, many states continue to require wet signatures and physical storage of certain transaction documents. While these protections may be considered luxuries to existing dealer operators, it is ultimately the consumer that will

drive evolution of the retail model and require the dealer to conform to their demands. Whether the majority of consumers opt to transact online or not, dealers will need to provide consumers with the ability to transact the way they prefer. Consumers, emboldened by digital technologies throughout their daily lives, are ultimately going to drive similar change in automotive retail. The question is whether auto retailers are nimble enough to adapt with such change or risk being overshadowed by other competitors more aggressively embracing the digital retail revolution.

Aside from consumer benefits, there are also clear financial advantages for dealers by investing in a streamlined, digitally-infused dealership sales and service process. Technology can help reduce contracts-in-transit from weeks to days to hours. Digital interfaces can reduce the title transfer and clearing process for used vehicles, resulting in less time required and increased accuracy of used vehicle accounting/auditing processes. These demands can overly tax dealership personnel and require substantial investments in additional dealership management and oversight, all of which takes time and focus away from key goals, such as improved used vehicle sourcing and reconditioning, among other critical non-customer facing dealership operations.

According to a 2019 Urban Science webinar presented by Automotive News Power Training, 65-70% of consumers believe a vehicle subscription service would allow them to "own" a vehicle without a long-term commitment, always have access to the best in-vehicle technology and drive their "dream-cars" on a more regular basis, while only 39% of consumers would be willing to pay more for the service.

According to a 2019 Urban Science webinar presented by Automotive News Power Training, 78% of dealers believe a vehicle subscription service is likely to be used vs. 35% of consumers.

There is growing debate regarding vehicle subscription programs, though to this point the few that have offered pilot programs have rarely found success. Vehicle affordability remains a key concern for the industry broadly, as highly technical hardware and software powering advanced in-vehicle technologies drive up new and used retail prices alike. Subscription models may do little to counter affordability concerns, as incessant vehicle price inflation may push subscription costs higher as well, driving more consumers looking to downsize from vehicle fleets toward ride-sharing. To the degree ride-sharing demand accelerates, dealers may need to consider owning and managing a fleet of vehicles made available to ride-sharing drivers and perhaps consider utilizing subscription models (for vehicle usage and vehicle service alike) as a development lab to prepare for these shifts in demand.

According to a 2019 Urban Science webinar presented by Automotive News Power Training, dealers are considering multiple formats to engage consumers, including semi-permanent dealerships in large metropolitan areas (70%), pop-up displays at high-traffic events (66%), mobility points for vehicle sharing, service and delivery (69%), and experience and test drive centers (63-67%).

There are others that consider more drastic changes to the current dealership model, whereby dealers provide galleries for consumers to look at and test drive vehicles, but maintain inventory off-site or vis-à-vis a just-in-time replenishment model direct from the factory. There are some that believe competing dealers may consider or once again opt to pool inventory on lots where rent is less expensive, either through joint-venture partnerships or perhaps a factory-sponsored inventory management program. The difficulty with such a model is, however, how to handle aged inventory and how dealers would share in the losses related to disposing of slower moving inventory.

Another opportunity to disrupt the existing dealership model would be for third parties to offer customers financing and insurance products (e.g. extended warranties, GAP, etc.) separately from their vehicle purchases, which would eat away at a key profit stream for auto retailers. This more than likely will be driven by younger generations, but nonetheless dealerships will need to be aware of such trends and continue adapting in order to keep these valuable and viable businesses in-house.

THE DEALERSHIP OF THE FUTURE

As in prior reports, Auto Team America began its task by performing a survey of the dealership body and what we have found supports the primary changes in the dealership business model. The result of these surveys, analysis by industry experts, past research and interviews conducted for this paper have all been synthesized into our conclusions below.

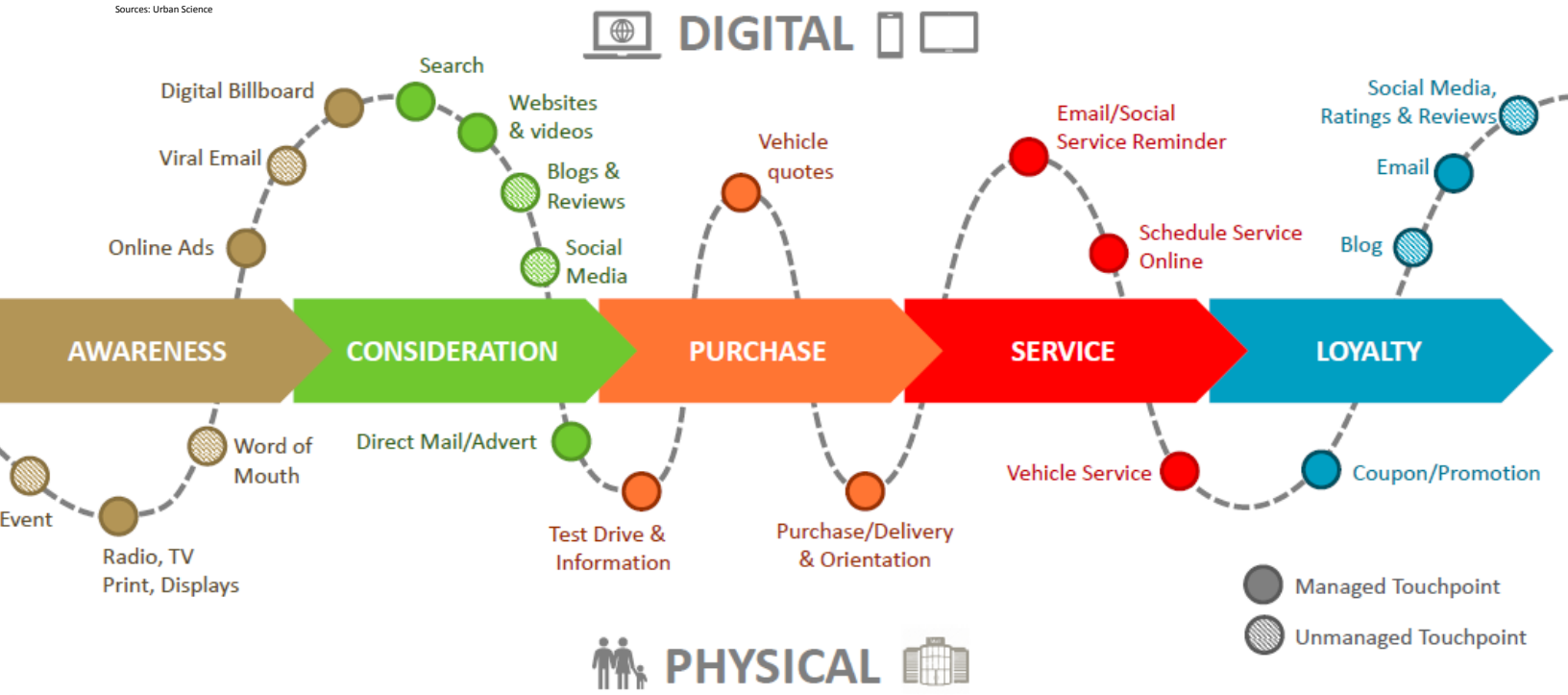
It is fair to say that to date, many predictions dating back to the 1980's have never materialized, in particular (a) manufacturers taking over dealerships and selling directly to consumers, (b) a shift to online-only transactions and the closure of brick & mortar auto retailers, (c) multiple Chinese & Indian manufacturers entering the U.S. market, and (d) more comprehensive consolidation across OEMs. However, retail automotive is evolving at perhaps the fastest pace in decades, driven by consumers' growing desire to interact and transact online. There have been titanic shifts in other types of consumption across generations of the consuming population. A key question for franchise dealers will be how they invest in systems, personnel and processes across sales and service in order to keep pace with evolving consumer tastes.

a) Sales Environment

According to a 2019 Urban Science webinar presented by Automotive News Power Training, 75% of consumers do not want to buy a vehicle without a dealership involved.

As of our last report, dealers were grappling with challenges related to the lead development process. The focus and investment dealers applied to lead generation and development has resulted in improved processes, which have helped to streamline the sales experience.

Building upon that momentum, dealers are now facing more complicated digital challenges, not the least of which is consumers' growing appetite for online engagement and ultimately, online transactions. The rise of online-only used retailers such as Carvana, Vroom, and Shift have opened the door for consumers to request more from independent used and franchise dealers alike. In order to differentiate in the auto retail environment of the future, franchise operators must consider implications for (a) personnel, (b) profitability, and (c) market share as more engagements move online and away from the physical dealership location.



CarMax, the largest and most dominant brick-and-mortar pre-owned vehicle retailer, sees consumers falling into three categories (1) customers who want the entire transaction online, (2) customers who want to shop on their own terms both online and in-store, and (3) customers who prefer to shop up close and complete the entire transaction in-store. Simply put, CarMax is betting that a hybrid or omni-channel solution will be best suited to serve all customer needs as auto retail continues to evolve.

So how does a traditional franchise operator convert into an "omni-channel" retailer? Certainly an important first step concerns lead generation and digital engagement, which are two concepts dealers are quite familiar with today. We believe dealers will continue optimizing digital strategies to systematically reduce reliance (and costs) related to digital vendors by generating more leads organically, helping to reduce advertising costs per retail unit. However, a growing digital footprint requires evolving in-store costs related to sales and service personnel as well as customer support among others. Sales people will serve more as "product specialists" and service advisors/ technicians more as "brand geniuses." We anticipate an expanded digital sales process may result in the majority of buying activity completed away from the dealership. Interactive kiosks in showrooms and sales from remote locations will dramatically alter personnel required to complete transactions. The rapid adoption of online-only models among used retailers may presumably stimulate further contraction in the number of franchise dealerships to the degree online-only retailers can continue gaining share by operating with a substantially lower cost structures relative to physical dealers. There could potentially be a race to the bottom on price that brick-and-mortar dealers simply cannot win, which could re-shape the retail landscape forever.

Increased digital engagement may also present challenges related to F&I activities, which dealers will likely absorb into the overall sales process. Feedback from our industry thought leaders suggest many operators are concerned that credit-worthy customers will be increasingly pre-screened and approved online prior to purchase, which may result in reduced F&I income to the retailer. Others note new factors could be used to evaluate credit-challenged customers, which may further constrict dealers' ability to convert a sale both in-store and online. Shifting decision-making regarding consumer credit may result in sub-prime financing becoming a larger portion of franchise businesses in the future, which may have significant profit but also regulatory implications in time.

There seems little doubt regarding the increasing digital influences throughout the automotive retailing process. Less clear is consumers' appetite for alternative ownership and/or transportation solutions. Many large manufacturers and technology companies view "Transportation as a Service" ("TAAS") as a potentially monumental shift that could cast massive structural changes across auto production, retail and consumption. Many industry participants are asking whether vehicles will become increasingly commoditized, viewed more as common tools to efficiently move people and packages throughout the economy rather than accessories that convey status or style. After all, some would argue vehicles are no more than expensive, inefficient pods of depreciation, which suck up extraordinary percentages of cash flow despite consumers only utilizing these tools for a tiny percentage of their useful lives. Franchise dealers struggle to understand how this paradigm would potentially influence their business model and if so, how quickly would the dealer body have to evolve into a "fleet manager" of sorts. Subscription services (which have largely failed to this point, arguably) offer some form of a testing ground but ultimately the main indicator may have more to do with the evolution of autonomous vehicle technologies.

b) Fixed Operations

As variable operations gross profit pressures mount for auto retailers, it is imperative dealer principals consider how they plan to adapt to evolving consumer tastes and digital technologies that are impacting their substantially higher margin fixed operations businesses.

Clearly there are opportunities for dealers to leverage investments in digital engagement that benefit their service businesses, including the transition to online appointment scheduling. The most digitally focused franchise dealers extend digital engagement to text message and in some cases video feed updates for work-in-process. Electronic signatures for work approvals and digital payment have also helped to streamline productivity through dealers' service lanes.

The evolution of vehicle technologies is also important to consider as operators ponder the dealership of the future. It seems there is a consensus that vehicles today are generally made better and therefore last longer than vehicles of the past. On the surface, this would imply more service and parts opportunities during the life of a vehicle. The increasing complexity of vehicles has likely benefited franchise dealers as well, considering the expanding computing power, array of sensors and electronic systems controlling vital vehicle operations. Although the aftermarket enjoys rights that prohibit OEMs from offering monopoly service and parts market share to franchise

dealers, it is often a question of talent and expertise that drive consumers back to franchise operators in light of the growing technical complexity of vehicles.

Looking ahead to the next 10-15 years, there will likely be further increasing complexity among the vehicle fleet. Manufacturers are universally focused on attaining more stringent global regulatory fuel economy requirements and many believe hybrid vehicles will serve as an important profit bridge between internal combustion and fully electric powertrains. It is likely, given the existence of two powertrains vs. one, that hybrids will be substantially more complex vs. ICE vehicles and therefore should benefit franchise dealers as production ensues in the coming years.

However, the increased penetration of hybrids is also likely to contribute to the falling cost of electric batteries. Lower battery costs should pave the way for more fully electric vehicles, which are simpler and present fewer service and parts opportunities relative to ICE vehicles for franchise dealers over the long-term. EVs may also require a change in technician skill sets, who may serve more as information technology specialists than wrench-turners. Perhaps dealerships will split into two areas, one for ICE vehicles and the other for hybrid/EVs, which will allow dealers to gradually transition to EVs while retaining existing ICE customers.

Regardless of powertrain, there is a growing number of OEMs moving to over-the-air software updates coming with newer vehicles that may reduce the need for dealership service visits. There may also be benefits for dealers that find ways to capitalize on remote communications as vehicles inform consumers when there are service issues and then are referred to local dealers.

There also remains a key debate as to how EVs will affect service and parts and whether service employees will travel to the vehicle or will customers continue to travel to the dealership. There will likely be changes to the role of the technician as service intervals grow for EVs. Questions remain regarding the need for factory-certified technicians, which may result in a lessor role for independent service centers in time. Alternatively, will there be opportunities for franchised operators to open independent service centers and refer warranty-related work to branded dealers.

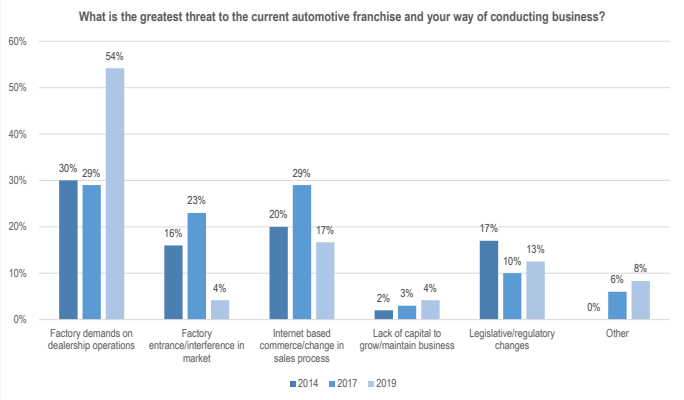
There may also be opportunities ahead with respect to factory-authorized collision centers, driven by the increasing complexity and wider variety of vehicles (e.g. body panels, powertrains etc.). By example, the industry has already witnessed changes in service, parts and collision trends from advancing technology in the shift to aluminum bodied F-Series pick-up trucks, the best-selling light vehicle in America. Collision shops have had to modify operations in order to isolate aluminum-bodied vehicles during repairs, as aluminum shavings can corrode steel panels after contact. There may also be implications from rapidly advancing vehicle technologies forcing collision centers to recruit and retain higher skilled labor due to increasingly stringent factory-certification programs. Taken together, it seems dealer-operated collision centers may be unique beneficiaries of key product development trends looking ahead to 2030.

It is true that much longer term there is a shadow lingering over the collision market from autonomous vehicles, which will presumably help to reduce the number of accidents. Though while there remains a healthy debate on implications of AVs there is also evidence to suggest meaningful advancement and deployment of AV technologies will be several decades in the making. There may also be offsets in the transition to autonomous fleets as AVs have proven, if nothing else, that it is exceptionally difficult to properly anticipate and react in time to the actions of human-piloted vehicles, bicycles or in some cases pedestrian traffic. To that end, it is also possible collisions, and more likely costs, may actually increase in route to a “fully autonomous” future.

INFLUENCES ON FUTURE DEALERSHIP OPERATIONS

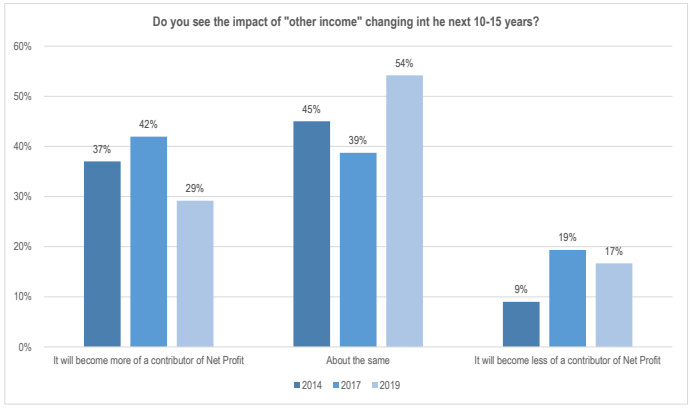
Continued Factory Influence

As we analyzed recent data relative to our prior surveys, it is clear a growing percentage of dealers believe that factory influence over the day to day operations of the dealership will continue. Variable gross margins will continue to be compressed and direct dealer payments from the manufacturers will need to continue as OEMs will need the dealership network to remain viable.



While dealers believe manufacturers' appetite to meddle in dealership operations will not subside, far fewer dealers see OEMs entering the market by going direct to consumers as compared to our prior surveys. Relative to prior papers, the long trend of pressure on front-end gross profit continues, which increases dealers' reliance on back-end payments from OEMs to maintain profitability on new vehicle sales. With greater incentives from the manufacturers comes greater influence and control on how the dealership conducts its business.

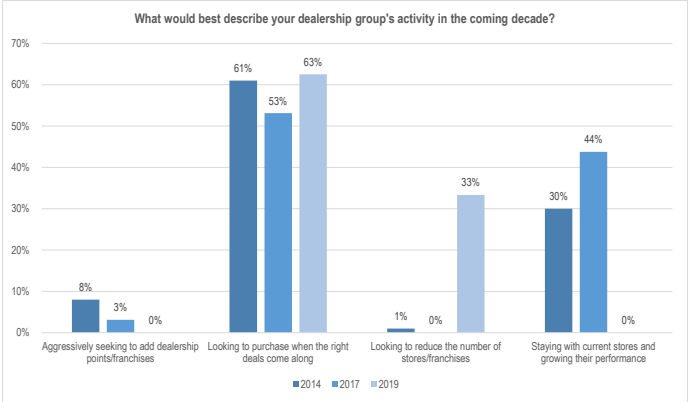
Since the factory incentives represent a key difference between being profitable or not – facility imaging, advertising requirements, and stocking guides will continue to encroach on dealers being able to react to local market conditions. As the only hold against the tide of manufacturers looking to micromanage the dealership, without taking any of the responsibility or capital risk will be increasingly specific state franchise laws protecting the dealership's investment, it is clear dealers see less risk to franchise law changes relative to our prior reports.



Dealership Consolidation and Ownership

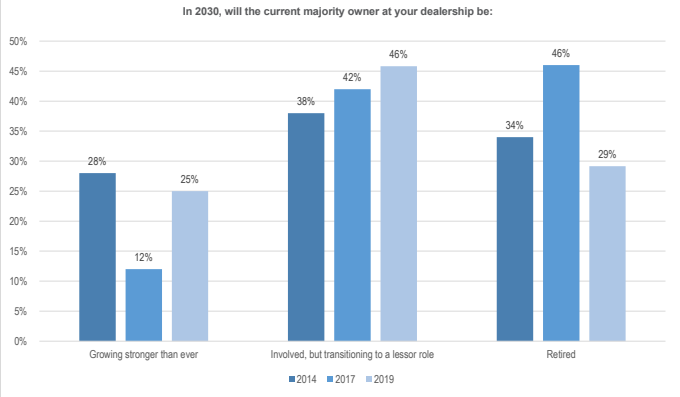
Private equity and family offices will continue to look at investing in retail dealerships, however certain OEMs are becoming more cautious with these types of investors. There will still be a place for family owned businesses with significant experience that are well capitalized.

While there were differing opinions regarding the nature of those changes in our paper three years ago, we did find a near unanimous agreement that dealership ownership was going to contract. For well over two decades, the narrative of dealerships has been one of consolidation. From the early days of growing regional groups, to the publics, the factory and now large private groups, it appeared there was nothing that would slow a progression of group consolidation.

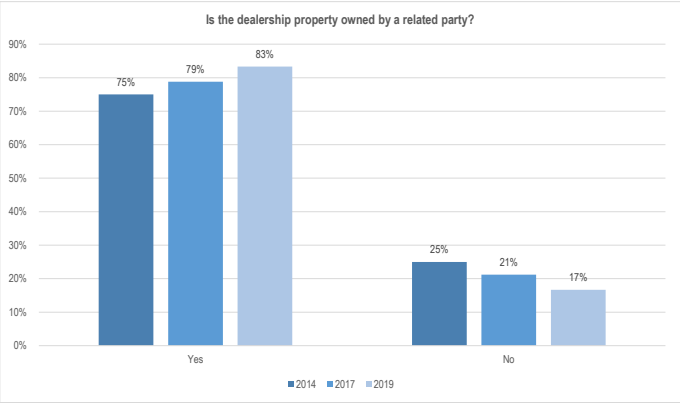


Among certain brands, primarily luxury and key midline imports, it remains a seller's market. While there continue to be many new willing buyers entering the marketplace, seller valuation expectations remain elevated, perhaps fueled in part by the resurgence in public dealer trading multiples during 2019. However, compression of gross margins, increased capitalization requirements and aging out of ownership among other factors will likely influence accelerated consolidation trends in the next decade. Factory demands for facility upgrades along with dealership relocation and reconstruction needs will likely

result in greater consolidation as many existing dealers will be unwilling to commit the capital needed to undergo major real estate renovation projects that may take decades to pay off. As shown in the chart that follows, it appears dealers' confidence is on the rise relative to our prior reports, which is perhaps contributing to current elevated seller valuation expectations.



That said, another interesting takeaway relative to prior surveys is the increase in dealership property owned by a related party, which rose to 83% in our latest survey from 79% in 2017 and 75% in 2014. This is perhaps notable as it seems any discussion related to "the next recession" has seemingly evaporated from the auto dealer narrative in 2020, at least relative to prior years. Low interest rates seem to fuel both (a) strong consumer demand for new and used vehicles (in conjunction with a widely available auto credit market) as well as (b) dealer principals' ability to acquire real estate at reasonably low costs of capital. Increased real estate ownership could, if nothing else, provide greater financial cushion and/or flexibility for dealer operators (relative to those that lease properties) should the economy hint at signs of a recession.

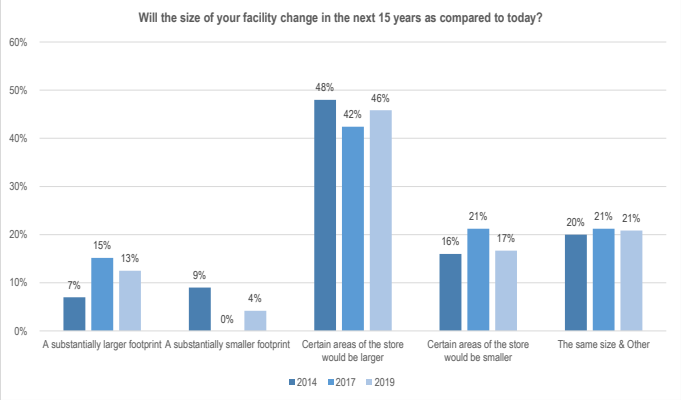


But should the economy begin to slide into recession, will there still be willing buyers in such a market? They are likely the ones with cash available and access to the capital necessary to complete acquisitions and make facility upgrades. While consolidation of stores into ever larger groups is easy to see, these will likely be regionally based groups of 20-30 stores. Those are the dealer groups that have shown to be the most efficient in growth, management and staffing. Single-point stores may still thrive and in many markets will be the right fit for the local community they serve.

Dealership Footprint

Dealership facilities are more complex than they appear on the surface. Facilities must balance the desires of the manufacturers, the needs of customers, reasonable capital expenditure by dealers, state franchise laws, existing dealership property and the local regulatory environment.

Yet, there are some forces that will work towards shaping the future look of dealerships. The current trend of bigger is better, does not necessarily hold true as dealerships look to have faster throughput of inventory, cleaner



"retail" environments and more efficient operations. If future dealerships must sell more vehicles, with fewer salespeople at lower operating costs, the logical conclusion is that dealership locations will shrink in physical size and footprint. The high price rents and real estate frontage on desirable highway and premier retail locations will be cost prohibitive for a large facility and footprint. Increasing throughput per store could help off-set these fixed costs, but the market for total vehicles sold does not project enough growth for this to occur.

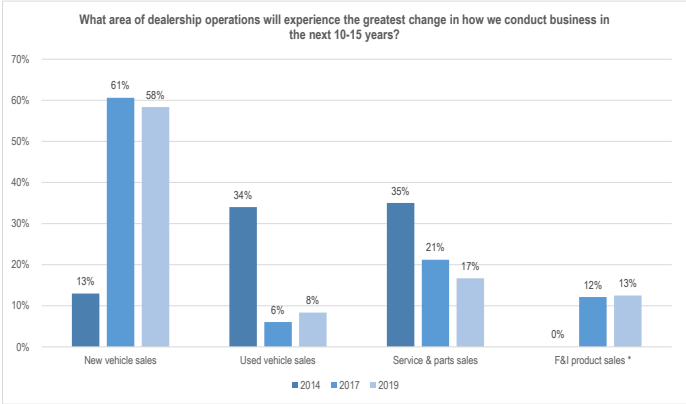
As rent and occupancy expense remains one of dealers' biggest fixed costs, it will need to coincide with the revenue structure of the dealership. So, why has there already not been a greater movement to reduce facility costs?

Moving to a smaller footprint is counter to most manufacturer goals. For obvious reasons, when the factory does not have any costs of building ownership it may want the biggest one it can force on the dealership body, with the most storage, parking and access. While dealership average annual unit sales continue to grow, there will be slumps in brands or even the economy that will put tremendous pressure on lowering occupancy costs. This will also put stores that currently operate on lower volumes at risk.

The only tactic to chisel away at the dealership's occupancy costs is marginally at specific operations. For example, off-site storage facilities have allowed dealerships to reduce costs. In the next decade, we should see improvements in efficient vehicle inventory management curtailing the need for storage space. Dealership consolidation does allow for the grouping of operations such as vehicle preparation, reconditioning and business offices into central, lower cost facilities. In some cases, off-site service facilities allow for servicing many makes in a much lower rent district.

Used Vehicles Hinge on Dealership Throughput

Compared to our 2017 survey, we note more retailers see an increased reliance on used retail transactions in the next 10-15 years. This will require dealers to adapt to used retail sourcing, reconditioning and sales processes that may be more complex relative to their new retail businesses. By 2030, the best strategy will be for dealerships to sell the same vehicle twice – once on the lease transaction and the second time as a certified pre-owned. Those dealerships that increase their capacity to recondition will get the pre-owned vehicle on the lot as quickly and economically as possible and will have the advantage.



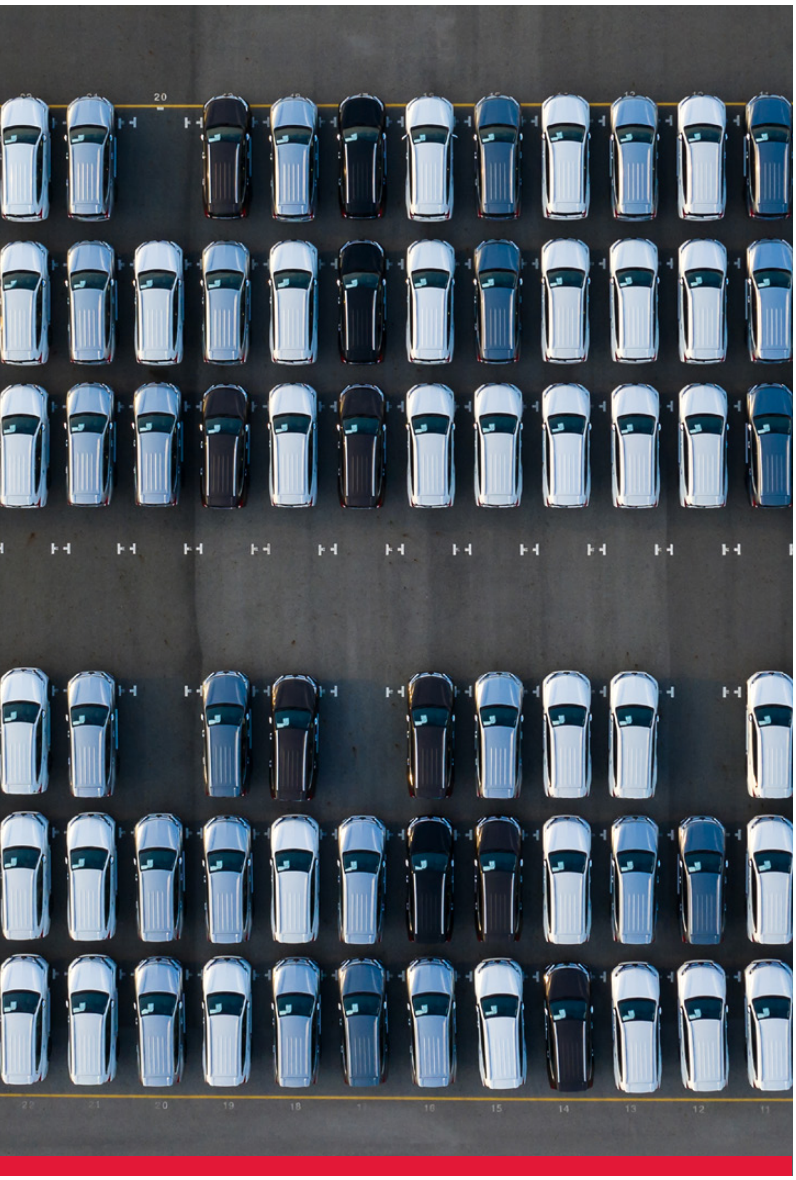
This will also be true in regard to the previously mentioned refurbished vehicles that are a step above certification. As models become more complex and given the potential for competitive devaluation of ICE vehicle trade-ins as noted herein, it might be difficult for dealerships to take competitive vehicles in trade. Same make stores will likely offer the best trade-in value for consumers. This will be a unique opportunity for dealerships that are part of a larger group that represent several brands.

In the non-certified and vehicle acquisition markets, technology has made the department much more efficient. Physical auction visits are rare, as program/remarketed vehicles are sold via online bidding. Outside wholesale buyers, likewise bid on vehicles in an online marketplace, allowing the dealership to maximize wholesale profits.

Auctions, the manufacturers, and other large remarketers of vehicles will be able to acquire more inventories for specific market demands. Market pressures will continue to push manufacturers to maintain high residual/pre-owned wholesale values – forcing more vehicles into their branded certification process.

Regulation of the F&I Profit Center

Prior surveys indicated that a growing percentage of dealers believed increased regulation would erode dealership profitability and make sales transactions even more complex. However, it seems those concerns have largely abated in the most recent data. As noted among larger public groups in recent earnings reports and filings, there appears to be substantial investment in digital



technologies (e.g. DocuPad etc.) that will help reduce the complexity of the F&I process and provide some relief to dealership staff and consumers.

Over time, as much of the customization of after-sale products and finance qualifications will happen prior to the close of the retail sale, we continue to see primarily F&I functions being reduced to compliance. New technical innovations will make compliance easier, so the final steps of the sales process will be performed with a delivery specialist or salesperson at lower cost to the dealership.

In some regards, such a vision paints a challenging outlook of the potential for profits on new vehicle sales in the Year 2030. In the sale process, F&I profits will continue to evolve from variable gross based on what the transaction will bear to a fixed "per-unit" basis with flat fees or commissions on the various products offered.

Higher Cost to Enter

We expect investment demand will continue to increase among strategic buyers (both public and private groups), private equity and family office investors. We also expect the number of dealerships on the market will continue to contract, as was the case over the past several decades. Therefore it stands to reason acquisition costs will likely increase in the coming decade. Less clear is how this relationship will translate to earnings multiples. At the moment, public dealership franchise groups are trading at or near all-time highs. Though there is generally a significant disparity of valuation multiples across brands, strong public valuations often result in higher private market transaction multiples. The injection of private equity and family offices, the ability of large groups to have a lower cost of capital and the ability to leverage their presence in the marketplace may continue to drive higher values for selective and desirable stores. Besides, or in some cases in spite of, the franchise brand, the dealership's real estate position (i.e., not overly built-out or burdensome) and the purchasing group's ability to economically assimilate the store into its other operations will also be key to the dealership's valuation.

New Market Entrants vs. Existing Automaker Consolidation

It seems less likely today, relative to our prior studies, that the market can support an influx of new brands, presumably from Chinese and other new OEM entrants. Many existing brands have struggled despite the industry's apparent economic resilience in recent years. The fear had been that one of these new players might try to circumvent the franchise protections like Tesla did, and enter with factory-direct stores, but it seems less likely today relative to prior years. In an age where experienced, well-organized manufacturers are fighting to maintain fractional market share, the entrance of yet another impactful automaker into the market does not look probable.

On the heels of the announced Fiat-Chrysler merger with Peugeot, what seems more likely is that OEMs seek to combine in order to offset rising production costs. Manufacturers' are struggling to earn suitable financial returns on their investments in light of increased competition across all vehicle segments and increasingly stringent global emissions and safety regulatory requirements. Global trade discussions also add a level of uncertainty with respect to broader production and distribution planning.

Though the impacts on retail automotive resulting from OEM consolidation will be difficult to predict with certainty, on the surface reduced competition may act as a temporary release valve for dealers currently

sacrificing new vehicle gross profit to achieve unrealistic manufacturer volume targets. There may also be opportunities for OEMs with stronger captive finance arms to support struggling brands, which lack the resources to effectively compete on a finance or lease monthly payment basis with larger incumbents.

Human Resources and Staffing – Discussed in "The Big 3"

Not only will dealerships be selling to a new generation of consumers but they will be hiring them as well. Indicators show that Generation Y, and possibly Generation Z, employees are more risk adverse and prefer security in employment over pure dollars. That would make most commission-based plans difficult for them to accept. What they will likely respond to is an improved benefits package and a clear job path. This group of workers also values their time and is less willing to work 60 hours a week that is often required in sales and F&I positions.

Because of the specialized nature of future transactions and business development activities, training at dealerships will also need to be increased to both comply with laws and maximize the individual's results.

By 2030, vehicles will be in communication with each other (V2X) and support common platforms to move towards autonomy, as well as the manufacturer's proprietary systems. This will require a level of "IT support" that must be instilled in future service writers and technicians.

Regulations Come Into Play

An ongoing theme though diminished relative to prior years in the retail automotive industry is the impact of potential changes to regulations and consumer protections that could meaningfully impact key profit centers for dealers. Few industries are as heavily regulated as retail automotive and no participant or observer of the industry expects that to change materially over the next decade. As noted previously, as new regulations come into play, dealerships must increasingly rely on technological solutions to assure compliance. Good technology will not be free and only dealership groups of a certain size or scale will be able to economically comply. Such regulations will also certainly come at a cost of compliance and potentially reduced gross. To that end, larger public and private groups have anticipated the potential of regulations requiring flat rate finance reserves and limited grosses by instituting caps on their F&I mark-ups, which may limit negative impacts on F&I margins vs. their peers.

YOUR 2030 AND BEYOND FINANCIAL STATEMENT

Financial performance results can be dangerous to examine myopically. One manufacturer might have a blockbuster year, the economy could weaken, and a region or area might experience a boom or a bust. In light of this, Auto Team America used NADA data from 2010 and 2019 to construct what could be the average dealership financial statement for 2030. In order to make an easier comparison, the following is shown in current (2019) dollars.

Average Dealership Financial Profile (all columns in 2019 dollars)

	2010	2019	2030
Total dealership sales	$41,632,873	$62,595,296	$68,854,826
Total dealership gross	$5,524,490	$7,223,215	$6,954,337
Total GP% of Sales	13.3%	11.5%	10.1%
Total dealership expense	$5,137,523	$7,094,927	$7,171,688
Net operating profit before taxes	$386,967	$128,288	($217,351)
New-vehicle department sales	$22,257,601	$34,415,669	$33,541,029
New-vehicle department gross	$1,434,710	$1,740,795	$1,278,736
New-vehicle GP%	6.4%	5.1%	3.8%
Used-vehicle department sales	$13,599,742	$20,295,599	$27,076,799
Used-vehicle department gross	$1,392,171	$1,827,473	$2,145,836
Used-vehicle GP%	10.2%	9.0%	7.9%
Used/New unit ratio	0.90	0.88	1.41
Service and parts sales	$5,733,108	$7,861,681	$8,236,998
Service and parts gross	$2,695,951	$3,654,947	$3,529,965
Service and parts GP%	47.0%	46.5%	42.9%
Other Income	$644,501	$1,353,235	$1,518,519
Total Profit	**$1,031,468**	**$1,481,523**	**$1,301,168**

As discussed previously, the analysis calls for compressed grosses in every department. One item showing no reduction is the Other or Non-Operating Income. The impact of Other Income items certainly varies between franchises. Volume bonuses, stair step programs, facility money, customer satisfaction rewards, and a seemingly never ending list of behavior controls from the factory have supplanted earning dealer profits from the public.

Auto Team America's analysis shows that a majority of dealership net income (across all brands) is generated from these types of programs. Often times this does not include volume bonuses that are increasingly added into new vehicle gross. While Other Income may include dealer

produced income such as documentary fees, rental vehicle income, interest income, etc.; for many dealers, it means factory-to-dealer payments.

The fear is that program cash is forever at the whim of the manufacturer. If the store relies on Other Income for its net income then it is in a precarious position when working with the factory. Further, even if the factory payouts remain the same but are changed from monthly to quarterly or semi-annually, the dealership has to be sufficiently capitalized to survive the dry season in between the incentive payments.

But from our surveys, dealers expect to rely more heavily on factory cash payments as a make-up of their income. Regardless of what form they take or demands they place on dealers, our survey clearly indicated that Other Income money will continue to be a major factor in dealership profitability.

Turning to the manufacturers side, the dealership's reliance on payments have become something of a paradoxical golden goose. Instead of laying golden eggs of "Other Income" for dealership benefit, it has become necessary that the manufacturers "Goose" keeps laying eggs or their distribution channel will collapse. Unless something replaces this "Other Income" for dealership operators, it may be in manufacturers' best interest to find other ways to supplement falling new vehicle gross profits.

The biggest change in the business model will be increased reliance on used vehicle sales. We project that used vehicles, as a portion of dealers business, will significantly increase. If the average 2030 dealership sells 913 new units, we estimate they will sell 1,285 used units. There will be several factors that will cause used sales to increase. Just like small dealerships are becoming rare, small used vehicle lots are too. The complexity of both the business and vehicles is anticipated to push small operators out of the market. Additionally, as manufacturers continue to launch low emission vehicles, many consumers may be priced out of the new vehicle market and therefore, may prefer an ICE alternative. Finally, with compressed margins across the dealership, dealers will need the additional gross dollars brought in by these used vehicle sales.

CONCLUSION

This paper has endeavored to summarize and where possible, dissect the very nature of "change" in the automotive retail business. It is true, predictions from prior papers may have been ahead of their time while others may ultimately prove just plain wrong. However, a

key difference today relative to prior periods is that there appears to be a consensus among key global automotive leaders that change is inevitable. Electrification is coming. Consumers will require omni-channel retail automotive solutions. Technologists continue to invest billions in autonomous vehicle research. That said, it is the pace of these changes that remains highly debatable.

Relative to other retail sectors, automotive retail enjoys one key, primary distinction – consumers do not buy vehicles as often as they upgrade iPhones. The extended duration between auto purchases affords auto retailers a golden opportunity to understand, study, embrace and then implement change at a much more gradual pace than other retail sectors. Given the advantage provided by a long purchase cycle, auto retailers would be making a fatal mistake to simply dismiss disruptors as "unprofitable, cash burning, doomed experiments." True, there is little benefit in being the "first mover" if consumers only buy vehicles once or twice a decade. However, is it without doubt that the shift to omni-channel retail is coming to the auto industry and to that end, it should be the primary motivation of traditional dealers to evolve into the best, most effective, most customer-friendly omni-channel solutions in the course of the next decade. The public buys and services vehicles in a million different ways, some unique by age or income, some unique by brand, some unique by region. Still, auto retailers must not ignore or dismiss change but rather listen, learn and evolve with the consumer. Resting on laurels or rationalizing inaction because of franchise protections would be a fatal mistake, in our view.

The next decade in automotive retail will separate the innovators from the resistors. Dealers should embrace the right kind of change at the right pace, but must make sure to evolve with consumers nonetheless. In the next decade, it is almost certain there will be economic headwinds and unrelenting business pressures driving lower gross margins and higher fixed operating costs, but in the words of Winston Churchill, "success is not final, and failure is not fatal: it is the courage to continue that counts."

Executive Summary

Our focus is on events occurring within the retail automotive space that the dealers will be able to influence, the most significant changes that may occur in the retail automotive business over the next 10 to 15 years and which industry disruptors will have the most influence in reshaping dealerships.

The "Big 3" disruptors to retail automotive stores are (1) People and Personnel, (2) Electrification and Autonomous, and (3) Dealership Evolution. There are also tangential considerations potentially benefiting retail automotive as the industry transitions to a more fully electrified, autonomous, omni-channel future.

People and Personnel

Hiring and retaining quality sales and fixed operations personnel remains without question one of the most important and challenging goals for auto retailers looking ahead into the next decade and beyond.

Electrification

As virtually all OEMs are planning to produce more hybrid and fully-electrified vehicles, dealers will need to keep pace with the level of investment required to educate consumers, offset potential internal combustion engine (ICE) vehicle devaluation and partner with public and private agents to build the charging infrastructure that will help power the transportation of tomorrow.

Autonomy

While it is clear the media hysteria has cooled and AV roll-outs delayed versus prior expectations, the public really wants the technology and they want to move in that direction. However, they are ambivalent as to whether they are willing to pay extra for it. In the interim, ATA expects the insurance market to experience more dramatic changes in the next decade given revolutionary vehicle technologies and shifts in vehicle ownership trends. This presents unique opportunities for dealer-owned, factory-certified collision centers and service shops.

Dealership Evolution

Auto retailers are facing mounting challenges, generally rooted in their customers desire to interact and consume more online rather than in-store.

Factory Involvement

It is clear a growing percentage of dealers believe factory influence over the day to day operations of the dealership will continue, though far fewer believe OEMs can effectively transition to a direct-to-consumer strategy.

Consolidation

Private equity and family offices will continue to look at investing in retail dealerships though there will still be a place for family owned businesses with significant experience who are well capitalized.

Acknowledgements

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Randall Hebert	Henderson Hutcherson McCullough, PLLC
Jason McCall	Dealer Safeguard Solutions
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